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# NAFTA, Authority and Political Behavior: The Case of Mexico

Sergio Puig\*

## I. Introduction

In force since 1994, the North American Free Trade Agreement (NAFTA) established one of the world's largest free trade areas, impacting almost a half billion people in North America.<sup>1</sup> Evaluations of NAFTA have largely come from the perspective of the three member parties,<sup>2</sup> pointing in multiple directions.<sup>3</sup> Much of the debate within the legal community centers on NAFTA's dispute settlement, a functional example of what political scientists call international legalization.<sup>4</sup>

Legalization of international law is understood as the coordinated attempts to

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1. North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 605, 702 [hereinafter NAFTA].
2. J. Enrique Espinosa & Jaime Serra, *Diez Años del Tratado de Libre Comercio de América del Norte*, in 1 EL NUEVO MILENIO MEXICANO 163 (Pascual García Alba Idunata et al. eds., 2004). See also Redacción, *Destaca EU beneficio del TLC para México*, REFORMA, Nov. 20, 2003, at 8A (quoting Robert Zoellick who stated "NAFTA has been a contributor in the democratization process of Mexico").
3. See Joint Publication, NAFTA: A Decade of Strengthening a Dynamic Relationship, available at <http://www.ustr.gov/regions/whemisphere/nafta2003/> (concluding that NAFTA "is an outstanding demonstration of the rewards to outward-looking countries that implement policies of trade liberalization as a way to increase wealth and improve competitiveness"). See also NAFTA's Promise and Reality: Lessons from Mexico for the Hemisphere, Carnegie Endowment Report Nov. 2003, available at <http://www.ceip.org/files/pdf/> (concluding that NAFTA has brought little benefit to the Mexican economy).
4. Frederick M. Abbott, *NAFTA and the Legalization of World Politics: A Case Study*, 54 INT'L ORG. 519 (2000) [hereinafter Abbott, *NAFTA and the Legalization of World Politics*].

strengthen the binding character, the enforceability, and the capacity to compel states' behavior through the adoption of precise obligations and the creation of dispute resolution mechanisms. Many legal doctrines, such as the sovereign immunity doctrine, the act of state doctrine, concepts of comity, and other legal barriers, undermine the ability of national courts to exercise this function effectively. Legalization includes three dimensions: obligation, precision, and delegation. Obligation means that states are bound by a rule or commitment and that behavior is subject to scrutiny under international law, and often under domestic law as well. Precision means that rules unambiguously describe the conduct they require, authorize, or proscribe. And delegation means that third parties have been granted authority to implement, interpret, and apply rules, to resolve conflicts and to make new rules.<sup>5</sup>

NAFTA is an example of legalization in international law and trade regulation and, for some authors, the triumph of legalization as the preferred method of international economic integration.<sup>6</sup> The NAFTA-style model of legalization has, as its main features, a high degree of precision and obligation of legal norms as well as a moderate degree of delegation of decision-making authority.

Recently, scholars writing under the liberal school of international law theory have posed strong claims that the future of enforcement in international law is through domestic mechanisms, given the ability to affect, influence, bolster and even order specific actors in domestic politics.<sup>7</sup> This school of thought has celebrated the ability of international law to constrain and guide political behavior,<sup>8</sup> the decision-making processes,<sup>9</sup> and to limit strategic bargaining in political behavior at the national level.<sup>10</sup>

5. Kenneth W. Abbott, Robert O. Keohane, Andrew Moravcsik, Anne-Marie Slaughter & Duncan Snidal, *The Concept of Legalization*, 54 INT'L ORG. 401 (2000).
6. Abbott, *NAFTA and the Legalization of World Politics*, *supra* note 4, at 520.
7. Anne-Marie Slaughter & William Burke-White, *The Future of International Law Is Domestic (or, The European Way of Law)*, 47 HARV. INT'L L.J. 327, 350 (2006).
8. Abbott, *NAFTA and the Legalization of World Politics*, *supra* note 4, at 520-21.
9. Similarly, some scholars see international law and international legalization as a tool for internal democratization. See generally Steven R. Ratner and Anne-Marie Slaughter, *Appraising the Methods of International Law: A Prospectus for Readers*, 93 AM. J. INT'L L. 291 (1999).
10. The second effect of legalization – strategic bargaining in political behavior – should be understood in opposition to normative persuasion. The content of this attribution is not value-free since it implies that international law affects conduct not simply because it is costly or undesirable, but because it is wrong or unjust. In other words, political behavior follows from the value actor's commitment to principled beliefs as opposed to exclusive rational choice considerations based on cost-benefit calculations. See Kenneth W. Abbott & Duncan Snidal, *Values and Interests: International Legalization in the Fight Against Corruption*, 31 J. LEGAL STUD., 141, 149 (2002).

Through assessing the dispute resolution mechanisms of NAFTA and using data produced in the proceedings, this paper analyzes the extent to which NAFTA has served as a source of constraint and guidance for bureaucratic decision-making processes, as the liberal scholars claim. This analysis is limited to Mexico, the weakest party to the agreements — given that in the unequal exchange and negotiations of the Agreement, Mexico viewed NAFTA not only as a necessary step for economic transformation, but also as a potential tool for locking in the new economic model and as a source of political transformation. This research has placed particular emphasis on exploring three instants of potential policy divergence with NAFTA: 1) the 1995 Mexican peso crisis; 2) Vicente Fox's rise to power, ending seventy-one years in which the *Partido Revolucionario Institucional* (PRI) controlled the executive branch; and 3) the political crisis resulting from the 2006 presidential election. In general terms, this article seeks to analyze the following question: How does legalization of international economic law affect the behavior of the Mexican government? This paper intends to embrace the complexity of the question and to resist the temptation to value ends over explanation.

#### *A. Structural Changes in Mexico in the Early Nineties*

Responding to calls by the International Monetary Fund (IMF) and the World Bank for liberalization of the Mexican economy, the Salinas Administration (1988–1994) implemented a wave of market-oriented reforms, starting in 1984 with the accession to the General Agreement on Tariffs and Trade (GATT) signed by his predecessor.<sup>11</sup> Under the Presidency of Carlos Salinas, Mexico took decisive internal and external steps to liberalize its economy, open its market to foreign trade and investment, reduce the state role in the economy, and establish rule-based principles for business activity. The reforms reached their peak with the adoption of NAFTA, which was signed on December 17, 1992, and entered into effect on January 1, 1994.

Prior to NAFTA, Mexico adopted an aggressive series of reforms that either permitted Mexico to gain the benefits of the Agreement or were indispensable in coordinating the new legal framework made necessary by entering into the Agreement. Following renegotiation of Mexico's external debt, the Mexican Government took the following measures, among others:

May 1989. Mexico altered the foreign direct investment regime by enacting a

11. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT].

new set of regulations which allowed 100 percent foreign ownership in a number of sectors and created a new council (*Consejo Mexicano de Inversión*) as a mechanism to promote foreign investment in Mexico.<sup>12</sup>

December 1989. Mexico adopted a new “*Maquiladora Decree*,” enacted to promote the establishment of in-bond plants for exporting industries.<sup>13</sup>

December 1990. President Salinas sent an initiative to the Congress to reform the Mexican Constitution to allow for privatization of banks. Mexican commercial banks were opened to some foreign investment and returned to private hands by May of 1990. Between 1991 and 1992, the process for divestiture of all eighteen banks was completed.<sup>14</sup>

June 1991. Mexico adopted the Industrial Property Law and created the Mexican Institute of Industrial Property (IMPI) as the intellectual property authority.<sup>15</sup>

January 1992. The government reformed Article 27 of the Mexican Constitution to permit a foreign corporation to own rural and agricultural lands and to eliminate some restrictions on transfer of *ejidos*, or “communal land” property.<sup>16</sup>

December 1993. Mexico amended its expropriation law to increase protection and security of property.<sup>17</sup>

December 1993. Mexico enacted antitrust legislation and created a Federal Competition Commission to serve as the Mexican antitrust authority, which aimed to promote competition and make it easier for enterprises to enter new markets previously dominated by powerful state-endorsed domestic enterprises.<sup>18</sup>

12. Reglamento de la Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera, DIARIO OFICIAL DE LA FEDERACIÓN (Mexican Official Gazette) [Foreign Investment Regulations] 16 de mayo de 1989 (Mex.) [hereinafter D.O.]. Dr. Jaime Serra, the Secretary of Trade and Industry in 1989, summarized the new Mexican philosophy as “embracing foreign partners [as evidenced] in the sweeping liberalization of the regulations governing foreign investment - as well as the deregulation and privatization of major economic sectors- and other profoundly important policy initiatives.” Promotional Brochure, (Mexico Investment Board) Oct. 1991, 3, (document on file with author).

13. Decreto que Establece Programas de Importación Temporal para Producir Artículos de Exportación, [Decree amending the Programs for the Temporal Imports to Produce in México Export Goods], as amended, D.O., 29 de diciembre de 1993 (Mex.).

14. PEDRO ASPE, ECONOMIC TRANSFORMATION THE MEXICAN WAY 90 (1993).

15. Ley de la Propiedad Industrial [Intellectual Property Law], D.O., 27 de junio de 1991 (Mex.).

16. Reforma que modifica el artículo 27 de la Constitución Política de los E.U.M. [Amendments to article 27 of Mexican Constitution], D.O., 6 de enero de 1992 (Mex.).

17. Decreto por el que se Reforman, Adicionan y Derogan Diversas Disposiciones de la Ley de Expropiación [Decree that Modifies and Amends the Law on Expropriation], D.O., 22 de diciembre de 1993 (Mex.).

18. Ley Federal de Competencia Económica [Economic Competition Federal Law], D.O., 24 de 366

December 1993. The government adopted a new Law on Foreign Investment, which elevated protection of foreign investors and their investments and allowed foreign investment in most of the economic sectors, replacing a twenty-year-old law.<sup>19</sup>

During that same period the Mexican Congress authorized the reformation and restructuring of many government agencies to facilitate interaction with newly created agencies and counterparts in Canada and the US. The Secretariat for Commerce and Industry (SECOFI, which is currently known as *Secretaría de Economía*) was granted broad powers to implement the agreement and to interact with foreign authorities. Other Secretariats such as *Hacienda y Crédito Público* (Tax Authority)<sup>20</sup> and *Relaciones Exteriores* (Foreign Affairs) and the newly decentralized *Banco de México* (Central Bank)<sup>21</sup> were granted functional powers consistent with the new economic model and regional trade relationship.

### ***B. The early effects of the NAFTA***

In economic terms, the three economies of North America have grown during the first decade of NAFTA. The average annual real GDP growth over the period 1994-2004 was 3.6 percent for Canada, 3.3 percent for the United States, and 2.7 percent for Mexico (despite the serious recession in 1995).<sup>22</sup> Both trade and investment grew considerably during this same period of time. The constant growth in terms of the GDP has to be analyzed with caution since it cannot, by any measure, be considered exceptional for Mexico. For example, compared to the 35-year dictatorship (1876-1911) in which Mexico grew at a faster rate than the United States, Mexican growth is slow.<sup>23</sup> Despite much criticism, opinions suggest that NAFTA has helped Mexico achieve levels of development closer to that of its

diciembre de 1992 (Mex.).

19. Nueva Ley de Inversión Extranjera [New Foreign Investment Law], D.O., 27 de diciembre de 1993 (Mex.).
20. An example of this is the audit process and the recommended verification procedures. Article 506 of the NAFTA sets out the authority for each Party to the Agreement to conduct verifications of the books and records of the exporter or producer located in the territory of another NAFTA Party. See NAFTA, *supra* note 1, art. 506.
21. See Nueva Ley del Banco de México, D.O. Dec. 23, 1993 (New law of the Mexican Central Bank) (granting the Central Bank autonomy and decentralized from the direct presidential control).
22. G.C. Hufbauer, Notes on Speech "Assessing NAFTA, CAFTA and the FTAA", Foundation Conference North American Agriculture: Assessing NAFTA at 12 Friday, Jan. 13, 2006: Sacramento, California, available at [http://giannini.ucop.edu/Hufbauer\\_NAFTA.pdf](http://giannini.ucop.edu/Hufbauer_NAFTA.pdf).
23. Stephen Haber, Armando Razo, and Noel Maurer, *THE POLITICS OF PROPERTY RIGHTS: POLITICAL INSTABILITY, CREDIBLE COMMITMENTS, AND ECONOMIC GROWTH IN MEXICO: 1876- 1929*, 48 (Cambridge University Press 2003).

partners, and that NAFTA has had positive impacts on the number and quality of jobs in Mexico.<sup>24</sup>

Since the beginning of NAFTA's enforcement, trade between Mexico, the US, and Canada has grown considerably. According to G.C. Hufbauer, the total two-way US-Mexico merchandise trade has grown 227 percent. Likewise, US-Canada trade has continued its robust expansion inspired by Can-US FTA.<sup>25</sup> Since 1989, US exports to and US imports from Canada rose 140 percent and 190 percent respectively; however, total US-Canada trade roughly kept pace with trade growth in the rest of the world. Trade with NAFTA partners in 2004 accounted for 31 percent of the total US trade, but more than 80 percent of Mexico's trade involves the NAFTA region.<sup>26</sup>

Foreign investment trends, particularly in Mexico, show an upswing after NAFTA. There is no clear evidence on whether NAFTA was the main causal reason for this increase or if it was the result of a general worldwide increase in FDI, the growth of the U.S. economy during these years, or the 1995 Mexican financial crisis. The displacement of foreign investment, mainly from the United States but also from Canada, into Mexico was a real phenomenon; however, some analysts suggest that this displacement was more a response to the productive adjustments stemming from the globalization of the world economy rather than to NAFTA itself.<sup>27</sup>

Thus, NAFTA evidently produced a stronger economic link and convergence between the three North American economies.<sup>28</sup> In some sectors, there is clear evidence the liberalization process has had a positive effect. For example, evidence suggests that foreign banks have been better able to screen borrowers and charge lower interest margins than domestic banks. Better financial options have derived from increased bank administrative efficiency. The implication is that foreign banks' entry after liberalization reforms produced welfare gains to consumers in Mexico.<sup>29</sup>

24. Lederman, Maloney & Servén, *Lessons from NAFTA for Latin America and the Caribbean Countries: A Summary of Research Findings*, at V (The World Bank Dec. 2003).

25. Hufbauer, Gary Clyde and Jeffery J. Schott, *NAFTA: An Assessment*, Institute for International Economics (Washington D.C. 1993).

26. *Id.*

27. Mattar et al., "Foreign Investment in Mexico After Economic Reform," in *Estudios y Perspectivas* 37-38 (CEPAL ed., 2002).

28. See Mexico: Canada's Other Nafta Partner, Report of the Standing Senate Committee on Foreign Affairs of Canada, 3 Mar. 2004, available at <http://www.parl.gc.ca/37/3/paribus/commbus/senate/Com-e/fore-E/rep-e/rep03mar04-e.htm>. See also Espinosa & Serra Puche, *supra* note 2, at 23-31.

29. Stephen Haber & Aldo Musacchio, *Foreign Banks and the Mexican Economy, 1997-2004*, 368

The economic implications of NAFTA help set up a framework to analyze the real question that this paper explores; they show how, from an economic point of view, NAFTA delivered nothing unexpected by serious analysts.<sup>30</sup> Less clear, however, is the extent to which NAFTA has affected governmental behavior. How national decision-making of the Mexican government has been affected since 1994, and to what extent this is the result of the NAFTA and reforms triggered by the Agreement, is less clear and seldom analyzed. These questions are explored below.

### *C. Legalization and International Law Compliance*

#### **1. Observation Sample: Dispute Settlement Mechanism As Evidence of State behavior**

Observing a causal relationship between a normative framework and political behavior is not an easy task. Econometrics and statistical inference are helpful tools if adequate data is available. For the purpose of this work, data seems to be inadequate for a sophisticated empirical analysis.<sup>31</sup> Instead a “multiple-case”<sup>32</sup> study methodology, adequate to develop a better explanatory framework, and to refine theories, has been suggested for similar types of analysis.<sup>33</sup> The process-tracing followed is also helpful to understand links between the factors studied and political behavior.

Dispute settlement mechanisms created under international agreements not only serve as a threat to the discretion of political leaders but also contribute in the ability to monitor compliance with an international agreement and to understand the behavior of state actors. International proceedings under these mechanisms can also be an important source of information about political conduct and help trace behavior. In other words, dispute settlement mechanisms may have an

Aug. 29, 2005, available at [http://www.stanford.edu/~haber/papers/HaberandMusacchio-ForeignBanks\\_andtheMexicanEconomy,1997-2004.pdf](http://www.stanford.edu/~haber/papers/HaberandMusacchio-ForeignBanks_andtheMexicanEconomy,1997-2004.pdf).

30. Hufbauer, *supra* note 25, at 10.

31. For an example of an empirical analysis in this field, see e.g., Oona A. Hathaway, Do Human Rights Treaties Make a Difference?, 111 YALE L.J. 1935, (June 2002).

32. Methodological design deals with the logical sequence that connects the empirical data to its conclusion. In general, case studies are the preferred strategy when “how” and “why” questions are being posed. A multiple-case analysis follows a replication logic. It serves to explore similar results and to compare and contrast predictable different results in the presence of different circumstances

33. Gary King, Robert O. Keohane and Sidney Verba, *Designing Social Inquiry: Scientific Influence*, in QUALITATIVE RESEARCH 140 (Princeton University Press, 1994); Robert K. Yin, *CASE STUDY RESEARCH: DESIGN AND METHODS* (Sage 1994).



informational function.

NAFTA includes a unique package of dispute mechanisms covering regional trade and investment. The agreement presents a quasi-judicial approach, based on international mechanisms, that incorporate elements of court proceedings and arbitration panels. However, NAFTA avoided trilateral judicial mechanisms such as those in the European Union or permanent international tribunals such as the ICJ.<sup>34</sup> NAFTA's dispute resolution provisions cover foreign investment, financial services, appeals on antidumping and countervailing duty actions, and state-to-state disputes.<sup>35</sup> Each of these provisions has affected policy autonomy differently.

NAFTA mechanisms resemble other international instruments entered into by the United States. For example, NAFTA mirrors the Can-US FTA as to the resolution of state-to-state disputes as well as antidumping and countervailing duty determinations. The investor-state mechanism was borrowed from many bilateral treaties existent at the time.<sup>36</sup> Some provisions included in NAFTA have been included in other regional agreements entered into independently by Mexico and the US — most notably with CAFTA<sup>37</sup> but also with the Mex-Japan FTA.<sup>38</sup> Two other mechanisms related to NAFTA, the North American Agreement on Labor Cooperation (NAALC)<sup>39</sup> and the North American Agreement on Environmental Cooperation (NAAEC),<sup>40</sup> also provide for proceedings that review the failure to enforce the labor and environmental provisions established therein.<sup>41</sup>

34. Cf. John P. Fitzpatrick, *The Future of The North American Free Trade Agreement: A Comparative Analysis of the Role Of Regional Economic Institutions and the Harmonization of Law in North America and Western Europe*, 19 *HOUS. J. INT'L L.* 1 (1996) (concluding that NAFTA does not provides for a "regional judicial institution with the authority to provide independent and uniform interpretations of international obligations and to definitively resolve disputes in a legalistic manner").

35. See generally Meg Kinnear, Andrea K Bjorklund, and John F.G. Hannaford, *INVESTMENT DISPUTES UNDER NAFTA: AN ANNOTATED GUIDE TO NAFTA CHAPTER 11* (2006).

Section of the Treaty	Type of Dispute
Chapter 20	General treaty obligations
Chapter 19	Unfair trade law enforcement
Chapter 14	Financial services
Chapter 11	Foreign investment

36. Daniel M. Price, *Some Observations on Chapter Eleven of NAFTA*, 23 *HASTINGS INT'L & COMP. L. REV.* 421, 422 (2000).

37. U.S. Trade Representative Draft Text of U.S.-Central America Free Trade Agreement, available at <http://www.ustr.gov/new/fta/Cafta/text/index.htm>.

38. Agreement between Japan and the United Mexican States for the Strengthening of the Economic Partnership (Sept. 2004), available at <http://www.mofa.go.jp/region/latin/mexico/agreement/index.html>.

39. North American Agreement on Labor Cooperation, 14 Sept. 1993, 32 I.L.M. 1499.

40. North American Agreement on Environmental Cooperation, 14 Sept. 1993, 32 I.L.M. 1480.

41. NAAEC is directed at fostering the protection and improvement of the environment,

In a general sense, the practice of the dispute mechanism serves as a useful source of information about states' behavior. Yet, analyzing only the practice is not conclusive for finding whether international obligations have actually (as opposed to theoretically) affected government behavior. This kind of analysis, however, can provide a good sense of the state of affairs with respect to compliance and political behavior adjustment to international law.

#### ***D. The Balance of NAFTA's Disputes Settlement Mechanisms 1994-2006***

##### **1. Chapter 11: Investor-State Dispute Settlement Mechanism**

Of the four dispute settlement mechanisms of NAFTA, Chapter 11 (Investment) has been the most controversial. Approximately forty-four notices of intent to submit claims to arbitration have been reported. Only four actions have resulted in violations of Chapter 11, where one of the Parties had committed violations of NAFTA: two against the Mexican Government, and two against the Canadian Government.<sup>42</sup> Three arbitral decisions and one consolidation order have been reviewed by courts at the site of arbitration: the *Metalclad*, *S.D. Myers* and *Feldman* awards, and the order in the softwood consolidation proceeding. Governments have duly complied with the tribunals' resolutions in a timely manner in all cases.<sup>43</sup> Cases like *Azinian*, *Waste Management*, *Gami*, *Mondev*, *ADF*, *Thunderbird*, *Fireman's Fund* and *Loewen* resulted in the dismissal of the allegations against the governments.<sup>44</sup>

The huge improvements in the degree of transparency of the mechanisms under

improving conservation efforts, promoting sustainable development, and increasing cooperation on and enhanced enforcement of environmental laws and policies. NAALC aims to improve working conditions and living standards, to foster compliance with and effective enforcement of labor laws.

42. Governments have been found responsible in: *Metalclad Corp. v. United Mexican States*, ICSID (W. Bank), Award (30 Aug. 2000) (per curiam) reprinted in 16 INT'L ARB. REP. 62 (Jan. 2001), paras. 101–12; in *Pope & Talbot, Inc. v. Canada* (10 Apr. 2001) (Award on the Merits Second Phase) (per curiam) para. 195; in *S.D. Myers Inc. v. Canada* (21 Oct. 2002) (Second Interim Award) (per curiam), paras. 318–19; *Marvin Roy Feldman Karpa et al. v. The Government of Mexico*, Final Award, ICSID (World Bank) Case No. ARB (AF)/99/1, 16 Dec. 2002, para. 96.

43. Currently, in the case of *International Thunderbird Gaming Corporation v. United Mexican States*, the respondent is seeking to vacate the arbitral award and therefore, the award will be reviewed –to a limited extent– by a judge in Washington, DC, the place of arbitration. *International Thunderbird Gaming Corporation v. United Mexican States*, Arbitral Award (NAFTA/UNCITRAL) 26 Jan. 2006, available at <http://www.iisd.org/pdf/2006/itnaward.pdf>.

44. *Id.*

Chapter 11 have helped to overcome much of the controversy and skepticism towards Chapter 11 arbitrations. During the last three years, there has been greater access to information about the disputes, the initial basis for much of its criticism against Chapter 11.<sup>45</sup>

## **2. Chapter 19: Antidumping and Countervailing Duty Actions Revision Mechanism**

Chapter 19 is the most utilized mechanism available under NAFTA. As of December 2006, the mechanism has had 108 filings under its provisions. In addition, Chapter 19 has seen the highest number of rendered decisions with a total of 50. Out of the total number of filings 35 were terminated by the parties and the rest are currently pending. There are also eight decisions pending. Out of the claims filed, 72 were against U.S. authorities, 20 against Canada, and 16 against Mexican authorities.<sup>46</sup> Around 85 percent of the cases refer to dumping and related issues; 15 percent concern subsidies. It is also interesting to note that the disputes have centered on relatively few sectors, such as metallurgy, construction, foods and agricultural products, and chemicals and manufacturers.

In contrast to other dispute mechanisms of the agreement, Chapter 19 is the most transparent. Proceedings are widely open, and with the exception of confidential business information contained therein, briefs, hearings, preliminary decisions, as well as final decisions are made public on a timely basis.

## **3. Chapter 20: State-to-State Dispute Settlement Mechanism**

Only three NAFTA disputes have tested the complete course of the state-to-state dispute mechanism established in Chapter 20.<sup>47</sup> In the first, the United States activated the mechanism against Canada, alleging that under NAFTA Canada's tariff on dairy products were subject to a tariffication and subsequent elimination

45. See Statement of the Free Trade Commission on Non-Disputing Party Participation, NAFTA Free Trade Commission (7 Oct. 2003), available at <http://www.dfait-maeci.gc.ca/nafta-alena/Nondisputing-en.pdf> (establishing guidelines for submissions from non-disputing parties in all cases; Canada and the United States affirmed that they will consent to open public hearings in all Chapter 11 arbitrations).

46. See Status Report NAFTA & FTA Dispute Settlement Proceedings, available at [http://www.nafta-sec-alena.org/DefaultSite/index\\_e.aspx?DetailID=9](http://www.nafta-sec-alena.org/DefaultSite/index_e.aspx?DetailID=9) (last visited Mar. 23, 2007).

47. David A. Gantz, Government-to-Government Dispute Resolution Under NAFTA's Chapter 20: A Commentary on the Process, 11 AM. REV. INT'L ARB. 481, 490 & 518 (2002) (referring to a dispute brought under the Softwood Lumber Agreement, May 29, 1996, 35 I.L.M. 1195, to resolve a long-running dispute between Canada and the United States over Canada lumber exports to the United States).

within 15 years. The panel ultimately determined unanimously that Canada's actions were consistent with NAFTA.<sup>48</sup> In the second case, Mexico brought an action against the United States based on the United States's application of a safeguard to brooms made of corn fibers. Under Mexico's view, the safeguard, as applied by the U.S. International Trade Commission, did not meet the standards required to establish the domestic industry injury required by NAFTA.<sup>49</sup> The Panel unanimously agreed with Mexico.<sup>50</sup> The third decision under Chapter 20 is the famous *Cross Border Trucking Services* case, in which the Panel agreed with Mexico that the "U.S. blanket refusal to review and consider for approval any Mexican-owned carrier applications for authority to provide cross-border trucking services was and remains a breach of the U.S. obligations."<sup>51</sup>

In spite of being actively used during the first years of NAFTA, the mechanism for state-to-state disputes under Chapter 20 has not presented a new case since 2001. Given that the arbitral panel process contemplates the use of a standing roster of ten international legal experts designated by each NAFTA party, and that the roster of members was not formed until this year the process and the mechanism's effectiveness was undermined. It may be the reason for the relatively few disputes submitted to arbitration under NAFTA. Without the roster, the constitution of the panel depended on the agreement of both of the states, difficult to gain once a disagreement has been triggered.<sup>52</sup>

## II. Environmental and Labor Side Agreements Dispute Settlement Mechanisms

The environmental side of the Agreement created a Commission for Environmental Cooperation (CEC) whose principal task is to investigate citizens' complaints that the NAFTA parties have failed to enforce their environmental laws

48. *Id.* at 515. See also Final Report of the Panel in the Matter of Tariffs Applied by Canada to Certain U.S.-Origin Agricultural Products, 1997 Bdielad Lexis 24 (Dec. 2, 1996).

49. In the dispute, the United States complied with the decision only after nine months. For that reason, Mexico applied retaliatory tariffs to a series of U.S. products, like high fructose corn syrup, until the U.S. lifted the safeguards. See AMERICAS TRADE, Dec. 24, 1998, at 8.

50. *Id.* See also Final Panel Report, in the Matter of the U.S. Safeguard Action Taken on Broom Corn Brooms from Mexico (USA-97-2008-01), Jan. 30, 1998.

51. *Id.* at 516. See also Final Report of the Panel Case Concerning the Cross-Border Trucking Services, USA-MEX-98-2008-01, Feb. 6, 2001 ¶ 295.

52. NAFTA, *supra* note 1, Arts. 1414-16. It worth noting that Chapter 14 (Financial Services) of NAFTA relating mostly to banking, insurance and brokerage issues provides that Section B of Chapter 20 and Chapter 11 shall apply, with some modifications, to the settlement of disputes on financial services. No cases have tested this system.

as the NAAEC requires. The citizen-submission process functions as another “information” mechanism for governments’ behavior, investigating the parties’ compliance with environmental laws and publishing its findings as factual records. According to Slaughter and Hale, four of the twenty-six completed CEC cases resulted in high levels of policy change and seven of these resulted in medium levels of policy change.<sup>53</sup>

Finally, the labor side of the Agreement created the National Administrative Offices (NAO). Citizens can submit claims to the NAO alleging that one of the other governments has failed to effectively enforce its labor laws. If the NAO decides to accept the submission, it may hold public hearings to gather information about the complaints. Upon receiving the submission the Secretary of NAO may then recommend that the NAFTA Party’s Labor Ministers consult on the submission. Close to thirty citizen submissions against member governments have been presented. Most of the submissions have raised complaints against Mexican authorities, the next largest number of submissions have been raised against the United States. Two cases submitted by *Maquiladora* workers in 1997,<sup>54</sup> the most renowned of these cases, involved union representation elections processes. As consequence of the cases, Mexico agreed to promote the use of secret ballots in union representation elections and to support the provision of information pertaining to collective bargaining agreements.<sup>55</sup>

#### ***A. State Behavior in Critical Moments: The Case of Mexico***

As explained before, this article has selected three critical points in Mexico’s recent history as case studies in analyzing states’ behavior under NAFTA. During these three periods, potential temptations existed that might have caused Mexico to diverge from the economic choices required under NAFTA. These temptations invited protectionist and discriminatory measures in contravention of international obligations. More importantly, these instances demonstrated an increase in political pressure and social tensions that required important public policy decisions. The objective of the three cases is to identify some links between political behavior and NAFTA in moments where sufficient internal political

53. Anne Marie Slaughter & Thomas N. Hale, Transparency: Possibilities and Limitations, 30:1 FLETCHER FORUM OF WORLD AFFAIRS 153, 159 (2006).

54. See Report to the Chairman, Subcommittee on Trade, Committee on Ways and Means, House of Representatives, *available at* <http://www.gao.gov/new.items/d01933.pdf>.

55. See Commission of Labor Cooperation, Public Communications Submitted to the United States National Administrative Office (NAO) U.S. NAO 940001 and U.S. NAO 940002, *available at* <http://www.naalc.org/english/summaryusa.shtml>.

pressure has demanded actions potentially in conflict with the Agreement.

### ***B. The 1995 devaluation crisis***

In December 1994, after a year of political assassinations, a controversial presidential election and an armed guerrilla movement in the impoverished southern state of Chiapas, Mexico teetered on the edge of a foreign exchange reserves crisis. In response, Mexico devalued the peso, sending the peso/dollar exchange rate from 3.4 pesos per dollar to more than two times that rate, 7 pesos per dollar. With almost no foreign currency reserves, huge liabilities convertible into dollars and with no one willing to lend hard currency to Mexico for fear of losing it in the clearly impending financial crisis, Mexico faced possible default on payment of liabilities, hyperinflation and a probable depression. A relatively successful peso rescue program, financed through a support package offered jointly by the White House and the IMF, prevented a larger Mexican crisis.<sup>56</sup>

Under these conditions Mexico faced severe domestic political pressure to take some form of action to address the financial crisis. The likely measures would potentially have isolated NAFTA by restricting trade liberalization and market access.<sup>57</sup> Suggested responses included actions taken in previous economic crises in Mexico; for example, in the 1970s and 1980s, restricting access to the internal market and engaging in programs of nationalization.<sup>58</sup> In the middle of the 1982 crisis, President Lopez Portillo (1976-1982) nationalized private banks and established foreign exchange controls.<sup>59</sup> Mexico's restrictive import policies, a reaction to the oil prices debacle during the first quarter of 1982, were required to sustain domestic production and they resulted in an unprecedented foreign trade surplus.

56. See Juan R. España, *The Mexican Peso Crisis: Impact on NAFTA and Emerging Markets*, BUSINESS ECONOMICS, July 1995. Some economic commentators have suggested that had the Clinton administration been willing and/or able to put together an aid package right after the devaluation, the extent of the crisis would have been reduced significantly.

57. See, e.g., Speech by Jorge Andrés Ocejo Moreno on behalf of the PAN in front of Congress's Permanent Commission requesting urgent trade protection for Mexican production. *Diario de los Debates*, LVI Legislatura, Comisión permanente, Primer Año de Ejercicio, 4 de enero de 1995 available at <http://cronica.diputados.gob.mx/DDebates/>.

58. See Henry C. Schmidt, *The Mexican Foreign Debt and the Sexennial Transition from López Portillo to De la Madrid*, Mexican Studies / Estudios Mexicanos, Vol. 1, No. 2. (Summer, 1985), 227-54. President Lopez Portillo announced the nationalization of private banks and the establishment of foreign exchange controls during the state-of-the nation address.

59. Decreto que Establece la Nacionalización de la Banca Privada, D.O. Sept. 1, 1982 (Bank's Nationalization Decree) & Decreto que Establece el Control Generalizado de Cambios, D.O. Sept. 1, 1982 (Foreign Exchange Controls' Decree).

President Zedillo's 1995 rescue package responded to the devaluation crisis by encouraging foreign investment and pointing to the importance of productive investments for Mexico that would reduce the need for imports in an "efficient" way. President Zedillo also announced a group of measures to deepen the structural change in Mexico toward a flexible and competitive economy, "particularly in those sectors that must be modernized quickly to encourage the productivity and competitiveness of [the Mexican] economy." In the same speech he "encourage[d] the participation of private investment in modernizing infrastructure for development."<sup>60</sup> While a tempting option for the incoming administration, the 1995 rescue package did not involve nationalization, market access limitations, or exchange controls, as Mexico had formerly done in previous crises and as was seen in Argentina's emergency package in 2001.<sup>61</sup>

The United States provided large-scale financial aid to Mexico during the peso crisis and thereby relieved the pressure on the Mexican government to take measures that might have been inconsistent with NAFTA. This can be seen as a positive effect in the Mexico-United States relationship. NAFTA aligned the common interests of both countries because they were better off cooperating to solve Mexico's devaluation crisis. The U.S. government had an incentive to show that the politically contentious NAFTA and the trade liberalization agenda were correct political-economy courses of action.<sup>62</sup> Furthermore, a great depression in the Mexican economy one year after NAFTA's coming into force would have undermined U.S. policy objectives for entering into such trade agreements, as well as affected U.S. private interests in Mexico.<sup>63</sup> To avoid this, it was important for the U.S. to support Mexico during the peso devaluation crisis.<sup>64</sup>

60. President Ernesto Zedillo, Address at Presidential Residence (Dec. 29, 1994), *available at* <http://zedillo.presidencia.gob.mx/pages/disc/dic-94.html>.

61. *See generally* Timothy J. Kehoe, What Can We Learn From The Current Crisis In Argentina? 50:5 SCOTTISH J. POL. ECON., Nov. 2003.

62. Interview with A. S. Weiner, former U.S. State Department Counsel involved in the loan negotiations between Mexico and the United States, Stanford, CA. (Jan. 27, 2007).

63. *See* Richard E. Feinberg, The Political Economy of United States' Free Trade Arrangements, 26:7 THE WORLD ECONOMY 1019-40. According to Feinberg, four broad objectives are pursued by the U.S. with this regional trade agreement: a) establishing an asymmetric reciprocity that advantageously opens markets for US traders and investors; b) establishing precedents, models or serving as catalysts for wider trade agreements; c) rewarding and supporting domestic market-oriented reformers; and d) strengthening strategic partnerships.

64. Bradford deLong et al, The Case for Mexico's Rescue; The Peso Package Looks Even Better Now, FOREIGN AFFAIRS, May/June 1996, at 8 (stating that "as a consequence of the crisis, guaranteed access to the U.S. market has become a more important determinant of long-term investment in Mexico, and Mexico's demonstrated commitment to reform policies has become more important for renewed growth").

In this cooperative scenario, the decision of Mexican authorities to take a course of action contrary to NAFTA would have been very costly for both the U.S. and Mexico but appealing to the masses. It seems that the bureaucratic authorities viewed NAFTA as a constraint on their policy discretion. For example, once the financial misfortune had been ameliorated, the government faced the task of rebuilding Mexico's financial and banking systems, which had been gravely damaged as a result of the substantial volume of non-performing loans. The Mexican government decided to do so through a program implemented by the Fund for the Protection of Bank Savings (FOBAPROA). FOBAPROA intended to quell the non-performing loan problems by taking over tranches (securitized bonds) of the banks' non-performing loans and replacing them with government-guaranteed notes. The program was implemented in spite of huge political pressure in Mexico against the program, especially after the PRI lost control of the Congress in 1997. This political pressure demanded discriminatory measures with respect to dollar denominated debentures that would affect, among others, U.S. investors. However, executive authorities were concerned that discriminatory treatment could trigger a dispute, and "if the disputes [were] submitted to international arbitration it was very likely that a tribunal would find breaches of international obligations, and Mexico would lose and be compelled to pay [compensation]."<sup>65</sup> In addition, the same authorities were "concern[ed] that Mexico's reputation in their international investment community would suffer."<sup>66</sup>

While some measures affected both Mexican and foreign investors, none of these actions has resulted in a finding of discriminatory breaches to NAFTA, in contrast to the measures taken by Argentina during the 2001 financial crisis.<sup>67</sup> In a way, NAFTA and the potential of international responsibility helped bond the fate of these two countries.

### ***C. Vicente Fox's Presidential Victory and the Mexican Sugar Industry***

The Mexican government went through a historic political change in 2000 when Vicente Fox Quezada of the *Partido de Acción Nacional* (PAN) won the

65. Testimony of Eduardo Fernandez Garcia, president of the National Banking and Securities Commission of Mexico submitted in *Fireman's Fund Insurance Company v. United Mexican States*, ICSID Case No. ARB (AF)/02/1, (NAFTA), Claimant's Memorial on the Merits at para. 58.

66. *Id.*

67. Cf. *CMS Gas Transmission Company v. The Argentine Republic*, ICSID Case No. ARB/01/8 (US/Argentina BIT) Award, 12 May 2005, available at [http://ita.law.uvic.ca/documents/CMS\\_FinalAward\\_000.pdf](http://ita.law.uvic.ca/documents/CMS_FinalAward_000.pdf) (condemning Argentina to pay the Claimant compensation in the amount superior of US \$133.2 million).



presidential election on July 2, 2000. His victory represented the first time in seventy-one years that the PRI had lost control of the executive branch. Fox's election left Mexico with a divided government, as the PAN did not control the Congress. Rather the opposition controlled the Congress's majority because the PRI retained the greatest number of seats in the Congress and was in alliance with another political party, the *Partido de la Revolución Democrática* (PRD).

Vicente Fox (2000-2006) won the election promising to bring change to Mexican institutions, increased accountability, efforts to end corruption, and positive economic reforms to boost Mexico's development. Despite this enthusiasm, President Fox was unable to deliver on these promises — the promises that helped ensure his party's victory in the 2000 election.

President Fox faced many challenges in his first year as President of Mexico; one of the most important involved the problems facing Mexico's sugar industry. Mexico is the world's sixth largest producer of sugar. Sugar cane is the single largest crop cultivated in Mexico.<sup>68</sup> Although highly inefficient, the sugar industry has important political implications because around 30,000 workers are employed in sugar mills and around 300,000, ten times that number, work in the fields as growers and cutters. It is estimated that more than two million people depend on this industry either directly or indirectly.<sup>69</sup>

The low price of sugar precipitated this crisis. This low price, when combined with the small U.S. import quotas offered to Mexico under NAFTA, the inability of the industry to export Mexican surpluses at competitive prices, and increasing competition from other sweeteners such as the High Fructose Corn Syrup (HFCS) intensified the problem. In an attempt to reduce this problem and as result of demand of the sugar industry, Mexico imposed antidumping duties on imports of HFCS from the United States in 1998. However, both a WTO and a NAFTA panel ruled against Mexico's imposition of these antidumping duties.<sup>70</sup>

In this context, Mexico was under an international obligation to lift the

68. International Sugar Statistics, <http://www.illovosugar.com/worldofsugar/internationalSugarStats.htm> (last visited Mar. 20, 2007).

69. See Gami Investments, Inc. v. United Mexican States (NAFTA), UNCITRAL Final Award 15 November 2004, ¶ 46, available at <http://ita.law.uvic.ca/documents/Gami.pdf>.

70. Mexico-Antidumping Investigation of High Fructose Corn Syrup (HFCS) from the United States, Report of the Appellate Body, WT/DS132/RW, 135, 2001 WTO DS LEXIS 29 (Oct. 22, 2001) (holding that Mexico failed to implement the Panel's original recommendations and ordering Mexico to conform to the obligations of GATT). See also Review of the Final Determination of the Antidumping Investigation on Imports of High Fructose Corn Syrup, Originating from the United States of America, Case: MEX-USA-98-1904-01, 112-13 (Aug. 3, 2001) (determining that the Mexican Investigating Authority failed to find a threat of injury to Mexico's domestic sugar industry), available at <http://www.nafta-sec-alena.org>.

antidumping measure or face retaliation by the United States. At the same time it needed to resolve the sectoral crisis. Mexican bureaucratic decision-makers faced the problem of solving the sector crisis with little flexibility to use trade measures as a result of the panels' findings.

In an attempt to address the crisis, the Fox administration made a controversial decision — it expropriated twenty-seven sugar mills by presidential decree on September 3, 2001.<sup>71</sup> Although this expropriation decree was ultimately declared a breach of the Mexican Constitution in national courts,<sup>72</sup> a Chapter 11 tribunal found the expropriation decree was not inconsistent with NAFTA. While Article 1110 of NAFTA prohibits discriminatory expropriation without adequate compensation,<sup>73</sup> compensation was offered in the present case and no elements of discriminatory intent inconsistent with NAFTA were found.<sup>74</sup>

In spite of the expropriation, pressures continued to mount from certain members of the Mexican Congress to reduce competition from other sweeteners. The Congress even proposed a ban on *all* imported HFCS and all yellow corn imported for the production of HFCS.<sup>75</sup> The Congress abandoned this idea because trade measures like the one proposed would be in “direct” contravention to NAFTA.<sup>76</sup> Instead, the Congress approved a 20 percent *ad valorem* tax to transfers (sales), imports, and services (such as distribution), in connection with the sale of soft drinks or syrups made with HFCS.<sup>77</sup> Because almost the entire HFCS industry

71. Decreto por el que Se Expropian por Causa de Utilidad Pública, a Favor de la Nación, las Acciones, los Cupones y/o los Títulos Representativos del Capital o Partes Sociales de las Empresas Propietarias de 27 Ingenios Azucareros. D.O., Sept. 3, 2001 (Sugar Industry Expropriation Decree).

72. Carlos Avilés, Corte Anula Expropiación de Ingenios Azucareros, Periódico El Universal, 17 de enero de 2006.

73. NAFTA, *supra* note 1, at article 1110.

74. Gami Award, *supra* note 71, at ¶ 114 (establishing that “[t]he government may have been clumsy in its analysis of the relevant criteria for the cutoff line between candidates and non-candidates for expropriation. [...] But ineffectiveness is not discrimination [...] a reason exists for the measure which was not itself discriminatory. That measure was plausibly connected with a legitimate goal of policy (ensuring that the sugar industry was in the hands of solvent enterprises) and was applied neither in a discriminatory manner nor as a disguised barrier to equal opportunity”).

75. Proyecto de Decreto que Prohíbe la Importación de Jarabe de Maíz de Alta Fructosa y de Maíz Destinado a la Elaboración de la Misma, Gaceta Parlamentaria, número 84, Sept. 19, 2001 *available at* <http://gaceta.diputados.gob.mx>.

76. This view has been confirmed, among others, by Senator Jose Casteñeda (2001-2006). Interview with Jose Casteñeda, Senator in Mexican Congress, Mexico City, Mexico (July 12, 2004).

77. See Decreto por el que Se Reforman, Adicionan y Derogan Diversas Disposiciones de la Ley del Impuesto Especial Sobre Producción y Servicios, Arts. 2, 3 and 8, D.O. 1o de enero de 2002 (explaining that under the IEPS Law, the tax paid by the bottler, distributor or

in Mexico (both at the production and distribution levels) is foreign-owned, the tax had an openly discriminatory intent.<sup>78</sup>

By passing the HFCS Tax, the Mexican Congress took direct action relying on fiscal prerogatives, perhaps in an attempt to shield the bill from challenges under trade agreements.<sup>79</sup> Political leaders in the Congress had previously attempted to undermine competitors of the sugar industry in Mexico by employing similar strategic behavior.<sup>80</sup> Nonetheless, the HFCS Tax was found in breach of GATT by a WTO panel and confirmed by its Appellate Body notwithstanding its fiscal nature. It is likely to be declared inconsistent with the NAFTA as well.<sup>81</sup>

In several different instances, high-level officers of the Mexican government expressed concern about this tax's consistency with international obligations and made efforts to repeal it. The Fox Administration suspended the Tax, recognizing the "unfavorable treatment" to foreign producers.<sup>82</sup> In an unprecedented battle over constitutional powers, the Supreme Court decided the executive branch lacked the authority to suspend a tax measure adopted by the Congress and reinstalled the Tax.<sup>83</sup>

Reliance on international agreements in decision-making is evidenced by the statements of government officials. For example, Mexico's Secretary of *Economía*, Mr. Luis Ernesto Derbez, stated that "[the Tax] violates NAFTA in the

importers when they sell or import the soft drink or syrup can be credited against the tax owed by their customers when their customers, in turn, sell the soft drink or syrup. However, since the final consumer cannot obtain a credit from the price to any subsequent consumer, the IEPS translates into a direct impact on the price of the soft drink).

78. Mexico – Tax Measures on Soft Drinks and Other Beverages Report of the Panel (WT/DS308/R) at ¶ 11.2.4 (finding Mexico's beverage tax inconsistent with Arts. III cl. 2 and III cl. 4 of the GATT 1994).

79. See *id.*, Observaciones de Mexico a los Comentarios de Estados Unidos al Informe Preliminar. (where Mexico argued within the WTO that the tax was adopted as a legitimate countermeasure and to secure compliance with law and regulations).

80. See Artículo Sexto Transitorio, Ley de Ingresos de la Federación para el Ejercicio Fiscal de 2002, D.O., Jan. 1, 2002. In order to import corn duty-free to produce HFCS into Mexico, a company must have a quota allocation, called *cupos*. The Mexican Congress changed the system and restricted the budgetary and allocation authority of the executive branch for that purpose.

81. Three investment disputes under chapter 11 of NAFTA remain. The claimants are Corn Products, ADM/A.E.-Stanley, and Cargill, available at <http://naftaclaims.com/disputes/mexico.htm>.

82. Decreto por el que Se Exime del Pago de los Impuestos que Se Indican y Se Amplía el Estímulo Fiscal que Se Menciona, D.O., Mar. 5, 2002.

83. Sentencia Relativa a la Controversia Constitucional 32/2002, Promovida por la Cámara de Diputados Congreso de la Unión, en contra del Titular del Poder Ejecutivo Federal, D.O. July 17, 2002. (Resolution Constitutional Challenge 32/2002 filed by the Chamber of deputies against the President).

section about investment protection and changes the rules of the game,” these changes would “have an impact on the legal framework that guarantees domestic and international investments in Mexico.”<sup>84</sup> Similar declarations were made by other officers.<sup>85</sup> This evidence suggests that the specific obligations of NAFTA were indeed considered in this debate over the sugar industry determining the appropriate course of action for Mexico and the executive’s response.

The fact that the administrative power was unsuccessful in this battle presents different and interesting questions of Mexican constitutional law, but for the purpose of this work it is clear that both the Congress and the executive had in mind an international legal framework while taking action on this issue. The HFCS Tax was ultimately lifted in 2006 in compliance with the WTO appellate body decision.<sup>86</sup> Simply lifting the Tax, however, does not preclude liability for potential violations of Chapter 11 of NAFTA vis-à-vis foreign investors.<sup>87</sup>

#### ***D. The Aftermath of the 2006 Election and The Political Unsteadiness of Corn.***

The extremely contentious 2006 electoral campaign in Mexico, ultimately won by Felipe Calderón (2006-2012), resulted in a post-election conflict mounted by the defeated candidate Andres Manuel López Obrador (AMLO). The situation left Mexico on the brink of major political and social turmoil. The campaigns of both Calderón and AMLO actively sought to exploit the country’s deep social divisions, and even encouraged these divisions at times. By charging massive election fraud after losing by less than 0.6 percent of the votes, PRD candidate AMLO sparked a political crisis in the young Mexican democracy.

AMLO had campaigned arguing against NAFTA and in favor of restricting market access, in open opposition to Mexico’s international obligations. On many occasions AMLO expressed a defiant voice against NAFTA, promising action to avoid compliance with international obligations, *e.g.* liberalization in sectors like corn and beans, and taking action on foreign ownership of banks.<sup>88</sup> As a way of

84. Ministro de Economía Aseguro que el Impuesto a la Fructosa Violó Tratado, EFE News Services, Mar. 7, 2002.

85. See Rebeca Céspedes, Critican Privilegio a Insumo, Periódico Reforma (Jan. 29, 2002) (quoting Dr. Luis de la Calle, Under-Secretary for Trade Negotiations).

86. See Ley del Impuesto Especial Sobre Producción y Servicios, Arts. 2, 3, 8, available at <http://www.diputados.gob.mx/LeyesBiblio/pdf/78.pdf>.

87. NAFTA, *supra* note 1, Art. 1135. Under Chapter 11 of NAFTA, the investor may seek monetary damages and any applicable interest or the restitution of property; however, it cannot request the removal of the affecting measure or punitive damages.

88. Andres Manuel López Obrador, Speech in Constitution Plaza of Mexico City, available at <http://www.amlo.org.mx/noticias/discursos/1609200601.doc> (“We do not accept the clause in the [North American] Free Trade Agreement by which in 2008 the imports, and

forestalling a political impasse following the close presidential election, Calderón promised to incorporate some of the PRD's economic agenda into his administration's agenda. In this context, political pressures to set back economic liberalization in general, and NAFTA (as the symbol of liberalization) in particular, have dramatically increased. Corn has been the new currency of this battle.<sup>89</sup>

In the first days of 2007, Mexico has experienced a rise in consumer prices and inflation, derived mainly from increases in corn prices. To control this, the PRD has used political pressure to suggest a schedule of price controls on products like corn and tortillas. However, noting Mexico's international obligations, Mexican executive authorities have decided to limit price controls, and instead, to increase the tariff-free import quotas of corn allocated under NAFTA. In addition, authorities have sought to attract more corn production investment in small and medium-sized farms in Mexico.<sup>90</sup> Mexican executive authorities have decided to honor trade liberalization commitments and to take advantage of NAFTA by increasing corn imports.<sup>91</sup> What is more striking is that NAFTA has been included in the main rhetoric for policy mechanisms. While influential leaders within the Congress have pressured against opening the border to this commodity, the administration intends to increase corn supplies from abroad and to comply with the scheduled liberalization.<sup>92</sup>

Once again we see that, as in the two examples cited before, in these critical moments, authorities within the government have acknowledged Mexico's international obligations. By relying on NAFTA as part of the solution to the corn supply crisis, Calderón's administrative action shows that international obligations are relevant in defining the bureaucratic decision-making process. Moreover, NAFTA, and compliance with it, has become an important part of Mexican politics as well as debates over policy decisions.

introductions of corn and beans from abroad will be [duty] free").

89. Elisabeth Malkin, Thousands in Mexico City Protest Rising Food Prices, *N.Y. TIMES*, Feb. 1, 2007.

90. Miriam Posada & Matilde Perez, No Habrá Control de Precios para Frenar el Aumento a las Tortillas: Sojo, *LA JORNADA*, Jan. 9, 2007. (Mr. Eduardo Sojo, (Secretary of Commerce) detailed the agenda [...] that considers subsidies to different sectors of the internal market and to exporters as well; furthermore, it attempts to attract more foreign investment and the strengthening of small and middle size businesses).

91. Mexico Cuts 'Tortilla Tax', *N.Y. TIMES*, Jan. 13, 2007, available at <http://www.nytimes.com/2007/01/13/world/americas/13mexico.html>.

92. Exhorto al Ejecutivo Federal a Establecer Mecanismos para Estabilizar el Precio de los Granos, *Gaceta Parlamentaria*, año X, número 2170, Jan. 11, 2007.

### ***E. Some Remarks on the Net Effects of NAFTA in State Behavior***

The early years of the 21<sup>st</sup> century demand that we pay special attention to the international institutions that have been created to deal with global affairs. Effective and fair international trade can help in the development of economies and improve living conditions as well as the quality of life in developing nations. International legal scholars should pursue careful analysis of the consequence of international law and institutions, and push for more effective legalization. If international law is ineffective, the role of power in world affairs increases. This scenario might not be a desired outcome for many of us who believe in the power of international law.

While NAFTA has not been the panacea to remedy Mexico's deep structural problems, a balanced view of the effects of the legalization of trade relationships requires an analysis of both economic and political effects. Thirteen years ago, relationships in North America were cordial and friendly as they are now, but power politics dominated the regional agenda. However, in the view of some scholars, a recent trend suggests that NAFTA style-legalization has "helped the management of Canadian, Mexican and U.S. relations [since] agreed rules and not power politics, has determined the outcomes."<sup>93</sup> This can be observed from the relatively low number of disputes, the preference for using trade mechanisms, compliance with the dispute mechanisms bodies' findings by the three States in almost all the cases and even policy changes in some cases.<sup>94</sup>

Of course, there have been exceptions where power has still trumped international law. Conflicts like the *Mexico-U.S. Sweeteners Dispute*, and the *U.S.-Canada Softwood Lumber Dispute*, in which investment-disputes, bi-national panel decisions, extraordinary challenges, remand and revision and in general never-ending litigation demonstrate the limitations of legalization.<sup>95</sup>

There is no question that authorities in Mexico have learned to deal with difficult policy decisions in a global and liberalized economy. In the following sections this paper argues that some evidence presented suggests the need for further, deeper analysis of the impact of legalization in three different ways. However, this conclusion should not be without qualification, in light of Mexico's unique political-economy dynamic and other economic, cultural and political

93. Gustavo Vega C. & Gilbert R. Winham, *The Role of NAFTA Dispute Settlement in the Management of Canadian, Mexican and U.S. Trade and Investment Relations*, 28 OHIO N.U.L. REV. 651 (2002).

94. *See id.* at section 4-b. (e.g., changes in labor, environmental and fiscal regulation).

95. Joost Pauwelyn, *Adding Sweeteners to Softwood Lumber: The WTO-NAFTA "Spaghetti Bowl" is Cooking*, 9 J. INT'L ECON. L. 197, 203 (2006).

changes. Also, this article is not an attempt to assess all the consequences of the Agreement, but only to point to some interesting dynamics where the Agreement has been relevant.

#### ***F. Constraint and Guidance in Decision-Making Processes***

As discussed earlier, the Mexican government's response to the 1995 peso crisis was driven by its liberalization program and by taking advantage of the recently adopted NAFTA. A response urging foreign long-term investment, efficient substitution of imports, and increase of trade was applauded and ultimately effective. Not only the initial response from Zedillo's administration, but also the eventual financial system's restructuring, avoided discriminatory actions and enhanced Mexico's international credibility. Given that Mexico depended greatly on an international constituency, *i.e.* the United States, to solve the peso crisis, credibility and commitment to its liberalization decision were essential for the success of the recently adopted economic model. Moreover, avoiding specific decisions to honor Mexico's NAFTA obligations clearly shows the impact of international law on bureaucratic decisions.

The second case of the sugar tax demonstrates an even greater example of an international framework impacting national decision-making. Not only did President Fox respond by suspending the openly discriminatory tax — expressing the reasoning behind the suspension — but some influential figures within the Congress also opted for a tax measure to avoid a “direct” violation of the agreement. This suggests a behavioral response of the Congress to the new rules of the game. In other words, political leaders within the Mexican Congress understand a two-tier game provided by national and international law, thus using policy devices like tax bills that enjoy a higher degree of discretion while providing adjustment assistance for import-competing industries. Ultimately, in the sweeteners case, the tax was declared illegal by the WTO. However, it would not be surprising if in the future, tax policy is used by the Congress to a greater extent in dealing with unpopular international trade commitments.

The last case of the 2006 elections, while simpler and subject to further developments, at least signals that Mexico's current administration seeks guidance in liberalization principles and from NAFTA to manage sector crises. A political battle is expected to surround compliance with the tariff schedule for corn next year<sup>96</sup> and, in this instance, perhaps international law will be used to confront local

96. Interview with Beatriz Leycegui, Mexico's Under-Secretary for Trade Negotiations, Mexico City, Mexico (Nov. 23, 2006 ).

politics. Both the Mexican Congress and the executive will face the battle considering the provision of NAFTA, thus, showing that in calculating different courses of actions, Mexico's political behavior has been constrained by NAFTA.

The above case studies suggest that in dealing with crises, political or economic, federal executive authorities in Mexico respond to international obligations. On the one hand, NAFTA appears to be a politically useful way of dealing with democratic tensions and suggesting certain courses of action. While on the other hand, they grant tools to limit national pressures by suggesting a particular course of action that differs from the administration's popular agenda. In other words NAFTA acts also as a "tying the hand device."<sup>97</sup>

While proponents of democratic values have good reasons to view the "tied hands device" rhetoric with suspicion, Congressional behavior could be adjusting. At first glance it might seem that in politically contentious battles or policy decisions, the executive branch in Mexico has appealed to international law to strengthen its case. For the Mexican executive, NAFTA has served as a series of commitment devices to be used in combating political pressure from leaders who demand backtracking in economic liberalization. However, a deeper look also confirms that the Congress has also adapted to this game and responded strategically. In the new political game created by these international obligations, the Congress has also modified its behavior. Some of these facts may signal that, as the liberal scholars suggest, international instruments can help guide local politics.

The executive's recent decisions resolving conflicts may have been economically motivated. Under this argument, the economic incentives determined the response, not the NAFTA agreement itself. The peso crisis response left Mexico better positioned than other countries in similar situations, *e.g.* Argentina. Had the Congress lifted the HFCS Tax as demanded by the executive, Mexico would not be facing potential international liabilities of nearly 525 million US dollars.<sup>98</sup> In the last case, experts even suggested that Mexico should anticipate the phasing out of tariffs on corn to avoid further economic

97. See Eric Reinhardt, *Adjudication Without Enforcement in GATT Disputes*, 45:2 J. CONFLICT RESOL. 174 (Apr. 2001) (concluding that "international institutions do indeed affect policymaking by changing the incentives for domestic actors, but not in a way imagined [...] by tying hands occur in proportion to the ex ante probability of enforcement, even if enforcement is not forthcoming in a given case").

98. See Pauwelyn, *supra* note 95. As stated before, three US sweetener companies (Corn Products, ADM/Stantley and Cargill) initiated proceedings against Mexico under Chapter 11. Together they seek a total of US \$525 million.



damages.<sup>99</sup> However, the claim of this article is slightly different. In spite of the economic incentives, the incorporation of NAFTA into the political rhetoric, the open statements of government officers about potential liabilities, and strategic behavior of the Congress show institutional caution and the responses to trade agreements. In this sense, NAFTA can be considered a new element that officials in both the executive and legislative branches must deal with in the exercise of their authority

### ***G. Trade Agreements and Strategic Bargaining in Political Behavior***

As explained before, scholars writing under a liberal tradition of international law view legalization as a limitation on strategic behavior. Strategic behavior concerns the use of international agreements by decision makers to act on the basis of principled beliefs, and not solely on rational and calculated decisions.<sup>100</sup> In an ideal scenario, compliance with international agreements will not be decided on the possibility of a sanction, but rather as a result of the belief that in the long-run it is beneficial and convenient to act in such a way.

Certainly this prediction has been more difficult to appreciate in a context like NAFTA. Indeed, the examples described before may suggest otherwise. NAFTA has encouraged an interesting political-economy dynamic demanding new courses of action when the democratic consensus is incomplete. The Mexican executive seems to take advantage of an international framework when arguing in favor of a certain course of action the executive prefers. Whether the motivation is to avoid the political pressure (the hands tied strategy), to avoid international sanctions, or is a result of the Agreement's concurrence with the administration's policies, the Mexican executive's behavior has been impacted by NAFTA. The Mexican Congress has responded to this game by extending the use of fiscal policy or limiting the trade authority it gives to the executive.<sup>101</sup> Thus, the strategic use of the Agreement within domestic politics is present, and it is indisputable that both the Congress and the executive are responding and adjusting to it. It is apparent that NAFTA has played an important role in this. Less clear, however, is whether the principles and values engrained by free trade have determined these actions.

Some hypotheses help explain why this prediction was not observed earlier.

99. Sergio Sarmiento, *Maiz y Mercado*, REFORMA (Jan. 15, 2007) (quoting Dr. Luis de la Calle, former Under-Secretary for international trade negotiations of Mexico).

100. See Ratner & Slaughter, *supra* note 9.

101. See, e.g., *Ley Sobre la Aprobación de Tratados Internacionales en Materia Económica*, D.O. Sept. 2, 2004, for the adoption of the new legislation establishing limitations on the executive branch in the celebration of international economic agreements.

First, NAFTA and the reforms were conducted under an elevated degree of isolation, without meaningful political discussions or any real democratic consensus.<sup>102</sup> Thus NAFTA lacks complete consensus, at least in Mexico, and when this is combined with the strengthening of some political forces and limited economic growth, the Agreement has created a political market to oppose the values and principles established by economic neo-liberalism.

The second explanation could be related to the subject matter of NAFTA. As opposed to human rights or non-proliferation agreements, the value of free trade agreements is perceived very differently by a large constituency. Indeed, in a 2005 survey, the percentage of Mexicans who considered NAFTA more beneficial to foreign interests was greater than those who perceived NAFTA to benefit Mexico more.<sup>103</sup> Therefore, this lack of acceptance creates grounds for the use of the agreement in a politically strategic way.

Lastly, Abbott's reference to governmental behavior constraints could be describing a unitary actor in its interaction with other States. Yet, the reality is that when it comes to trade issues, sub-state actors have different views as to what is in the State's best interest depending on their individual preferences. In this process, the national interest is subordinated and partisan politics create incentives for actions that will not be in the best interest of the country.

### III. Conclusion

This analysis suggests that NAFTA has impacted Mexico not only in economic terms. It also suggests that it has provided a vehicle for political reform in Mexico. This is perhaps, in part, due to the contribution of legalization of international law as a mechanism for controlling political behavior. More importantly, legalization in international law and trade regulation has instigated important new dynamics into Mexico's politics, evidenced by the behavior of government officials in different kinds of crises.

Three effects of legalization and NAFTA can be identified in the context of this paper. First, some evidence suggests that NAFTA works as a constraint of political behavior and as a guide for governmental decisions. In the three cases

102. Judith Adler Hellman, Mexican Perceptions of Free Trade: Support and Opposition to NAFTA, in *THE POLITICAL ECONOMY OF NORTH AMERICAN FREE TRADE* 193, 196 (Ricardo Grinspun and Maxwell A. Cameron eds., 1993).

103. Centro de Investigación y Docencia Económicas (CIDE) et al, México y el Mundo: Visiones Globales 2004. Opinión Pública y Política Exterior en México y Estados Unidos: Un Estudio Comparado, available at <http://www.consejomexicano.org/download.php?id=878671,186,2>.

analyzed, the executive branch of the Mexican government has relied on the Agreement in determining what course of action to pursue. The President, the Secretary of Commerce, and the National Banking and Securities Commission all expressly cited NAFTA in describing their reasoning behind certain decision. Thus, the Agreement worked as a policy device dealing with tensions between the executive and legislative branches, and was fully vested into the rhetorical of the policy decisions. This was demonstrated, in the first case, by establishing a course of action during the 1995 financial crisis; in the second case, by responding against discriminatory measures in the sweeteners sector crises; and finally, in the third case, by opening market access in the case of shortage of corn.

The second effect can be more puzzling for international law scholars. NAFTA seems to have granted the executive a tool to deal with political pressures and the defiance of the Congress. Evidence suggests that NAFTA was utilized by the executive branch as a “tying the hands” device to oppose exchange controls and protectionism in 1995, to suspend the HFCS Tax and to oppose import controls in 2002, and, to a certain degree, to respond to price controls of corn and tortilla pressures. While this argument is by no means new, the evidence of this article should be followed-up by further research to understand the use of NAFTA as a rhetorical tool to dissuade protectionist pressures.

Finally, NAFTA, together with many other legislative, economic and political reforms, has contributed to what seems to be a change in the political dynamics of Mexico. NAFTA has promoted the Congress’ anticipation of the employment of international economic agreements in the executive’s decision making process and the Congress’ strategic decisions to combat this. The Mexican Congress seems to be adapting — evidenced by their extending the use of fiscal policy, restricting the budgetary and duty-free quotas allocation authority as well as delimiting the trade authority to the executive. This adaptation to a new style of politics shows important signs that international law is being embedded nationally in Mexico.

The relationship between international law and state actions is a complex one and we cannot hope to provide useful policy advice with respect to international law without understanding this relationship. However, this article suggests further research to find concrete answers. This article should be interpreted with care; for example, the fact that federal authorities have responded in this way by no means concretely shows that international agreements have impacted the different institutional levels of the government.

Finally, in spite of the qualifications raised above, some evidence in this article may signal that some international scholars are correct in seeing international

legalization as a factor of municipal reform, an important function of legalization. Whether this new relationship between NAFTA, authority and political behavior is good or bad depends, to a certain extent, on the role of the Mexican authorities and courts to deal with some of these tensions. If these tensions are resolved with transparent decisions, consider international obligations and follow due process principles, Mexico could reduce its exposure to potential liability under the international disputes settlement mechanisms of NAFTA.